No. 22694

IN THE

United States Court of Appeals

FOR THE NINTH CIRCUIT

BEVERLY HILLS NATIONAL BANK, a national banking association,

Appellant,

vs.

COMPANIA DE NAVEGACIONE ALMIRANTE, S. A. PANAMA,

Appellee.

OPENING BRIEF FOR APPELLANT BEVERLY HILLS NATIONAL BANK.

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OPENING BRIEF FOR APPELLANT BEVERLY HILLS NATIONAL BANK.

Introductory Statement.

This admiralty action arises from the activities of Kenray, Inc. ("Kenray") which was engaged in the business of exporting scrap metal to the Far East. In November 1964, in order to deliver a cargo of scrap which had been sold to certain consignees in Taiwan (Formosa), Kenray chartered the vessel S.S. Searaven from libelant and appellee Compania De Navegacione Almirante, S. A. Panama.[1] The charter agreement, with which respondent Bank had no connection, pro-

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[1]Appellee was the libelant (plaintiff) below and appellant Beverly Hills National Bank was a respondent-claimant (defendant). For convenience, we will refer to appellee by its trial court designation "libelant" or as "Compania" and to appellant as "respondent" or "Bank".

vided for the payment by Kenray to libelant of charter hire of $96,750.00, to be paid within seven days after delivery of signed bills of lading. Kenray failed to pay any portion of the agreed charter hire.

The purchase price to be paid to Kenray for the scrap steel was arranged by the issuance of foreign letters of credit on behalf of the consignees. After the scrap was loaded on the Searaven, Kenray drew drafts against the letters of credit in favor of respondent Bank. Those drafts were paid and the amount thereof ($535,371.27) was applied upon Kenray's admitted indebtedness to respondent. Thereafter, libelant commenced this action, contending that it had a maritime lien upon the funds received by the Bank and caused a portion thereof to be attached and deposited in court pending this suit. The matter then proceeded to trial, after which the District Judge held that libelant had a lien claim upon the funds to the extent of the unpaid charter hire plus interest, and entered judgment accordingly. This appeal by respondent Bank followed. There is no material factual dispute and the ultimate issue of law is whether Compania has any superior lien or *in rem* claim upon the aforesaid funds received by the Bank.

Jurisdiction.

1. The judgment appealed from was made in an action in admiralty, which action seeks to impose a maritime lien upon funds which prior to the commencement of the suit were in the possession of respondent Bank. To that extent the action is one of which the District Court had original jurisdiction, being a case in admiralty, and the statutory provision believed to sustain the jurisdiction of the District Court is 28 U.S.C.A. §1333(1).

2. This Court has jurisdiction to review the judgment in that it is a final decision of the District Court. The statutory provisions believed to sustain the jurisdiction of this Court are 28 U.S.C.A. §§ 1291, 1294(1).

3. The pleadings showing the existence of the foregoing jurisdictions are the libel and amended libel in admiralty filed by Compania and the answers thereto and claim filed by respondent Bank. In the amended libel it is alleged: That on September 30, 1964, libelant entered into a charter party with Kenray for the S.S. Searaven for a voyage from California to discharging ports in Japan or Formosa [R. 139 (par. Third)][2] that the vessel was delivered to the charterer (Kenray) and libelant has a lien upon cargo for freight due [R. 139 (pars. Fourth, Fifth)]; that respondent Bank collected the proceeds of certain letters of credit in payment both for the cargo of the Searaven and the carriage of cargo against which libelant has a valid maritime lien right [R. 140 (pars. Eighth, Ninth)]; that said proceeds are within the jurisdiction of the District Court, are held by respondent Bank under color of its claim and that respondent will refuse to pay said funds to libelant unless compelled by order of court. [R. 140 (pars. Eighth-Twelfth)]. Respondent Bank admits that it received the proceeds of drafts drawn against certain letters of credit, but denies that such monies are freights, subfreights or proceeds upon which libelant has a lien, denies damage and asserts affirmative defenses including waiver and estoppel [R. 65-69; 161-168].

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[2]The Transcript of Record consists of two volumes, one of which is a Reporter's Transcript. A reference in this brief to the clerk's (file) portion of the Transcript is signalled by the abbreviation "R." followed by the page referred to. A reference to the Reporter's Transcript of the trial is signalled by the abbreviation "Rep. Tr." followed by the page referred to.

4. By its libel and amended libel, libelant sought to impose a maritime lien upon the funds received by the Bank. To the extent that the asserted lien was maritime in nature, there is no issue of jurisdiction. However, at pretrial and trial libelant asserted (over the objection of respondent Bank) that it had an "equitable" or "trust fund" claim upon the funds, and the judgment of the District Court in part is based upon conclusions of law that respondent was a "constructive trustee" and that it would be "inequitable" to deny recovery to libelant. [R. 226-227, Conclusions 8, 8A, 8B]. To the extent that the judgment is based upon such non-maritime considerations an issue is involved on this appeal whether the same are within the admiralty jurisdiction of the District Court. This issue is discussed in Part III, *A, infra.*

Statement of the Case.

1. The Pleadings.

The libel, as originally filed, was a single cause of action and alleged the making of the charter party between libelant and Kenray, the non-payment of the charter hire, the receipt by respondent of the proceeds of the drafts drawn against the foreign letters of credit and asserted a maritime lien against the proceeds to the extent of the unpaid charter hire of $96,750.00. [R. 2-5.] After exceptions were filed and overruled, respondent Bank filed an answer which in substance acknowledged the receipt of the proceeds of the letters of credit but denied that libelant had any lien thereon. [R. 65-69].

Subsequently, by an amended libel filed with leave of court, libelant asserted a second and separate cause of

action to claim a further maritime lien upon the funds received by respondent; that further lien was by way of indemnification for stevedoring charges of $24,699.17 claimed against the Searaven in a separate proceeding. [R. 138-143]. Both claims were specifically alleged to be maritime in nature and were not based upon any allegations of equity or a trust concept. [R. 140, 141-142 (pars. Eighth, Eighteenth, Nineteenth)]. An answer to the amended libel was filed by respondent again denying the existence of any lien rights in libelant [R. 161-168].[3]

Upon the filing of the suit, the District Court, at the request of libelant, issued an order to show cause why the monies received by respondent should not be attached and brought into court pending the determina-

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[3]The judgment of the District Court did not allow the claim for indemnification sought by the second cause of action of the amended libel and limited libelant's recovery to that sought by its first cause of action *i.e.* the unpaid charter hire plus interest. [R. 227-8, 230]. No cross-appeal was filed by libelant from the denial of its claim for indemnification; and that matter would appear to be final and not at issue here. [*Federal Rules of Civil Procedure,* Rule 73(a); *Moore's Federal Practice,* §72.05, Vol. 7, p. 3021 and cases collected; *Fidalgo Island Packing Co. v. Phillips,* 253 F. 2d 621, 622 (9th Cir. 1957); *Power Service Corp. v. Joslin,* 175 F. 2d 698, 704 (9th Cir. 1949); *Fanchon & Marco v. Hagenbeck-Wallace Shows Co.,* 125 F. 2d 101, 103 (9th Cir. 1942)]. The sometime rule in admiralty that an initial appeal opened the entire judgment for review without the necessity of a cross-appeal was ended by the 1966 amendments making the *Federal Rules of Civil Procedure* applicable to admiralty cases. [See: *Moore's Federal Practice,* §73.09 (1-6), Vol. 7, pp. 3171-3172; *International Milling Co. v. Brown S.S. Co.,* 264 F. 2d 803, 804 (2nd Cir. 1959) and *Rules of the United States Court of Appeals For the Ninth Circuit,* Rule 8.] Therefore, we will not address ourselves in this brief to the merits of the claim for indemnification (which involves some additional issues of law) and will limit our attention to the propriety of the imposition of a lien for the unpaid charter hire. We reserve, however, the right to reply if the issue of indemnification for the stevedoring charges is attempted to be raised here by libelant.

tion of the suit [R. 7].[4] After hearing the court confirmed the order to show cause [R. 55-56] and ordered the attachment and deposit of $145,000.00 (or alternatively the posting of a bond in said sum) pending the determination of the suit, such attachment to be without prejudice to the right of any party on the merits of the claims [R. 59-61]. A bond was filed in said amount [R. 62-64], followed by respondent's claim [R. 75-76] and the issues were thereupon joined.[5]

2. The Facts.

The pertinent facts are not in dispute and are reflected either in the findings of the District Court (most of which were stipulated) or in uncontroverted evidence. They may be summarized as follows:

A. Libelant is the owner of the S.S. Searaven [R. 219, Find. 1]. Respondent Bank is a national banking association with its principal place of business in Beverly Hills, California [R. 219, Find. 2].

B. Under a charter party dated September 30, 1964, libelant and Kenray (as charterer) entered into a voy-

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[4]The order to show cause was issued pursuant to former General Admiralty Rule 37, now reflected in *Federal Rules of Civil Procedure, Supplemental Rules For Certain Admiralty And Maritime Claims,* Rule C(3). This procedure is simply the device by which libelant asserts jurisdiction over the *in rem* respondent (*i.e.* the funds received by the Bank) so as to claim its alleged lien, and is without any determination of the merits of the lien claim. [See generally, *Moore's Federal Practice,* Vol. 7A, pp. 279, 606].

[5]In addition to the claim of lien asserted by libelant against the funds received by respondent Bank, which is entirely *in rem* in nature, libelant also asserted an *in personam* contractual claim against Kenray based upon its charter agreement. Kenray's default was entered upon stipulation [R. 170] and the judgment below included an *in personam* judgment against Kenray. That portion of the judgment against Kenray is not at issue on this appeal.

age charter party relating to the vessel Searaven, providing for a voyage from California to one or two discharging ports in Japan or Formosa. [R. 219, Find. 4; Ex. 1].[6] The charter agreement provided for the payment by Kenray to libelant of charter-hire of $96,-750.00, to be paid within seven days after delivery of signed bills of lading, all of which is unpaid [R. 224, Find. 17; Ex. 1].

C. Respondent Bank did not participate in the charter of said vessel nor did it enter into any contracts or agreements with libelant [R. 219, Find. 5].

D. In November 1964, the Searaven was loaded with scrap steel; the loading took place partly in San Francisco and partly in Los Angeles. [R. 221, Find. 9; Exs. 2, 3]. The cargo, approximately 10,000 tons in all, was steel which had been sold to certain consignees in Taiwan. [R. 220-221, Find. 8; Exs. 2, 3.] Kenray was the seller-shipper of all of the steel loaded except for 999.86 tons of scrap sold by Purdy International Corporation ("Purdy"), not a party to the suit. [R. 221, Find. 10]. Purdy paid to Kenray the sum of $9,998.60 for allowing its steel to be carried on the Searaven. That sum was deposited by Kenray into its commercial checking account with respondent Bank and subsequently set-off and applied on account of Kenray's indebtedness to the Bank [R. 223, Find. 15]. The steel exported by Kenray was procured by Kenray from domestic suppliers using borrowings made from respondent Bank; part of Kenray's debt to the Bank was secured by a security interest in steel stockpiled prior to exportation. [R. 219-221, Finds. 6, 7, 8].

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[6]Some of the provisions of the charter party have particular significance to the dispute here. Those provisions will be discussed in the substantive sections of this brief.

E. The purchase price to be paid to Kenray for the steel sold and shipped by it was arranged by foreign letters of credit issued by Bank of Taiwan and Bank of Canton, Ltd. at the request of the consignees in favor of Kenray, to be drawn against upon presentation of freight prepaid bills of lading and other documents. [R. 220-221, Find. 8; Exs. 4A-4I]. Upon the loading of the steel cargo, bills of lading were issued by libelant's duly authorized agent (the vessel's captain) and delivered to Kenray; these bills of lading all showed freight to have been *prepaid* and constituted contracts of carriage. [R. 221-222, Finds. 9, 11A; Exs. 2, 3]. None of the bills of lading was dated later than November 17, 1964 [*ibid.*]. The purchase price agreed to be paid by the consignees did not contain any allocation for freight [Rep. Tr. 47; Exs. 4A-4I].

F. After libelant's issuance of the freight prepaid bills of lading, between November 11 and November 18, 1964, Kenray drew drafts against the foreign letters of credit in the aggregate sum of $535,371.21 to obtain payment for that portion of the cargo sold by Kenray. Those drafts were all drawn in favor and to the order of respondent Bank. The drafts, accompanied by the bills of lading and other shipping documents, were presented to the foreign banks which had issued the letters of credit; the drafts were all *paid* between November 17 and November 29, 1964, and the Bank received the total payment thereof, $535,371.21. [R. 222-223, Find. 12; R. 176, Pretrial Order, P. 4, Par. 11]. At the time the drafts were delivered and payment made, Kenray was indebted to the Bank in the principal sum of $742,203.81. The funds paid on the drafts were applied on account of that indebtedness, leaving a balance

of in excess of $200,000.00 owed by Kenray to respondent Bank, which remains unpaid. [R. 223, 224, Finds. 13, 16].

G. The Searaven sailed from Los Angeles on November 22, 1964, bound for Taiwan (Formosa). It arrived in Honolulu, Hawaii, on December 31, 1964, where it remained with all of its cargo for a period of seventeen days; during said seventeen day period, some of the cargo was discharged from the vessel for the purpose of making repairs to the vessel and then was reloaded. The vessel then proceeded to Taiwan where it arrived on February 11, 1965; upon arrival in Taiwan libelant did not assert a maritime lien upon the vessel's cargo for unpaid charter hire and permitted said cargo to be discharged and delivered to the consignees without bond from them for unpaid charter hire. Libelant did assert a lien against said cargo for general average (repairs) for which a bond was supplied by the consignees. The discharge of cargo commenced February 18, 1965, and concluded March 20, 1965. [R. 221-222, 224, Finds. 11, 18]. At all times subsequent to loading of the cargo and prior to its discharge, the Searaven and its cargo were under the sole control of libelant and its agents; the Searaven was operated by libelant and all material aspects of the voyage were controlled by libelant; actual control of the vessel was exercised by its Master under direct instructions from libelant. [Rep. Tr. 124-126; R. 175, Pretrial Order Page 3, par. 6].

H. Kenray had chartered vessels prior to the Searaven. In some instances respondent Bank had loaned Kenray monies for the payment of the charter hire of such prior vessels, but in each such instance it had is-

sued its own letter of credit on behalf of Kenray. [Rep. Tr. 50]. No such letter of credit was issued in connection with the Searaven, and the Bank expressly desired not to issue a letter of credit for the Searaven charter hire so as to avoid any liability on the Bank's part. [R. 220, Find. 7; Rep. Tr. 41, 43, 50-51.] Respondent Bank at no time agreed or contracted to pay the freight or charter hire for the subject voyage of the Searaven. [R. 219, Find. 5; R. 175, Pretrial Order, Page 3, par 6]. At no time did any representative of the Bank represent or state that the Bank would pay the Searaven charter hire, [Rep. Tr. 54, 60, 104, 111] or that it would be paid out of the proceeds of the letters of credit. [Rep. Tr. 99, 45]. While there was no statement that the Bank would not pay the freight, an officer of respondent did specifically state to representatives of Kenray that Kenray would have to pay the Searaven charter hire. [R. 223, Find. 14; Rep. Tr. 111.] Kenray was able to procure the Searaven without a letter of credit because of its prior dealings with the brokers representing the owners of the Searaven and the establishment of Kenray's own credit with those brokers. [Rep. Tr. 51, 53].

Specification of Errors.

1. The trial court erred in finding and concluding that the funds received by respondent Bank from negotiation of the letters of credit were proceeds, freights or subfreights upon which Compania had a subsisting maritime lien. [See, Points I and II, *infra*].

2. The trial court erred in finding and concluding that it had jurisdiction to determine purely equitable and non-maritime claims, and in any event, erred in

finding and concluding that respondent Bank held the proceeds of the letters of credit and the monies paid by Purdy to Kenray as a constructive trustee for the benefit of Compania and that it would be inequitable if respondent Bank avoided payment of the charter hire. [See, Point III, *infra*].

3. The trial court erred in finding and concluding that Compania had not waived any lien it may have had, and erred in finding and concluding that Compania was not estopped to assert any lien claim. [See Point IV, *infra*].

4. The trial court erred in finding and concluding that Compania was entitled to judgment against respondent Bank and the *in rem* respondent (i.e. the attached funds) and in any event erred in awarding interest. [See Points I, II, III, IV and V, *infra*].

Summary of the Argument.

It was stipulated and found by the District Judge that respondent Bank had no contractual privity with libelant [R. 219]; accordingly, there could be no direct *in personam* liability on the part of respondent. The claim of libelant here is therefore an *in rem* lien claim against the monies received by respondent and attached. The lien claimed by libelant was based upon legal assertions that said monies represent either (1) proceeds of cargo, (2) subfreights, or (3) a trust fund, upon which libelant has a superior lien for the unpaid charter hire due it from Kenray. The issues of law therefore are:

> A. Do the funds received by the Bank represent proceeds of cargo; and if so, is there any lien thereon for the unpaid charter hire?

B. Did libelant have a lien upon subfreights of the Searaven; and if so, do the funds received by the Bank represent subfreights upon which a lien exists for unpaid charter hire?

C. Is libelant's claim of "trust fund" cognizable in a court of admiralty; and if so, is respondent a constructive trustee for the benefit of libelant?

D. Is libelant, under principles of waiver and estoppel, precluded from asserting any lien here by reason of its issuance of "freight pre-paid" bills of lading and its failure to assert any lien against the cargo of the Searaven?

Respondent Bank believes that under clear and unequivocal authorities, all issues here must be resolved against libelant and the judgment reversed. A summary of the argument may be stated as follows:

1. The owner of the Searaven (libelant) had a possessory lien upon the cargo; that lien was limited to the right to retain possession of the cargo on account of unpaid charter-hire and was lost upon the surrender of the cargo. The owner's lien upon cargo, being possessory in nature, does not extend to the proceeds of cargo. [Point I, *infra.*]

2. The monies paid to respondent Bank and attached were not subfreights; if they were subfreights libelant, by reason of the absence of an appropriate provision in the charter party, had no lien thereon. Furthermore, even if libelant did have a lien upon the monies as subfreights, that lien was lost and discharged

upon payment of the monies to respondent prior to assertion of the lien, and the lien may not be reinstated upon a tracing theory. [Point II, *infra.*]

3. There is no basis for a determination that respondent was a constructive trustee for libelant, in that there was no fraud, illegality, undue influence, mistake or violation of an express trust. The dispute here is between two creditors of Kenray and the fact that one got paid and the other did not, does not create any equitable claim in the latter. In any event, such a claim is not cognizable in an admiralty proceeding. [Point III, *infra.*]

4. Libelant is estopped to assert any lien by reason of its issuance of freight prepaid bills of lading, and by reason of its failure to assert its possessory lien against cargo. [Point IV, *infra.*]

5. In any event, interest was improperly awarded. [Point V, *infra*].

ARGUMENT.

I.

Compania Had a Possessory Lien Upon Cargo for the Unpaid Charter Hire. That Possessory Lien Was Lost Upon Surrender of the Cargo and Does Not Attach to Proceeds.

A. Libelant Shipowner Was Limited to a Possessory Lien on Cargo and Has No Lien on Proceeds of Cargo.

Libelant initially alleges that it has a lien for unpaid charter hire upon the funds attached, asserting that such funds are "proceeds of cargo".[7] Initially, we would concede for the purposes of argument that libelant had a lien upon the *cargo* for the unpaid charter hire (freight).[8] That lien against the cargo was a

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[7]While it is clear from the decisions hereinafter cited that the owner's lien does not extend to proceeds of cargo we would also point out that the assertion that the attached monies (the *in rem* respondent) represent "proceeds" is somewhat specious. At the time this action was commenced and the funds attached, libelant still had possession of the cargo aboard the Searaven. "Proceeds of Cargo", as the term is used in admiralty decisions, refers to what the cargo is converted into *after* the possession of the cargo is surrendered by the owner. [See: *Portland Flouring Mills Co. v. Portland Asiatic S.S. Co.*, 158 Fed. 113, 115 (D.C. Ore. 1907).] *Query*, then, how the funds here attached could be "proceeds of cargo". Nevertheless, for the purpose of this brief we will assume, as libelant alleges, that the attached funds are proceeds of cargo and demonstrate that there nevertheless is no lien thereon.

[8]"Freight", in admiralty terms, does not refer to the goods carried (cargo) but rather to the compensation to be paid to the shipowner. [Gilmore & Black, *The Law of Admiralty* (1957), p. 221]. In this case the freight was the agreed charter-hire to be paid by Kenray to libelant. "Subfreights", as used in the decisions and referred to *infra*, means monies owed to the charterer for the carriage of goods shipped by a third-party shipper. [*In re No. Atlantic, Etc., Co.*, 204 F. Supp. 899, 904 (S.D. N.Y. 1962); Gilmore & Black, *Op. Cit.* p. 208].

possessory lien entitling the shipowner (libelant) to hold the cargo until the freight due libelant was paid.

DuPont, Etc., Co. v. Vance, 60 U.S. 162, 171 (1856);

4885 Bags of Linseed, 66 U.S. 108, 113 (1861);

The Eddy, 72 U.S. 481, 494 (1866);

Gilmore & Black, *The Law of Admiralty* (1957), p. 190, pp. 516-517.

The shipowner's possessory lien is clearly limited to the cargo itself. The sole remedy of the shipowner to recover unpaid freight is to assert his possessory lien against the cargo. The possessory lien is lost by a surrender of the cargo and cannot thereafter be asserted. The possessory lien of a shipowner does not attach to proceeds of cargo.

4885 Bags of Linseed, 66 U.S. 108, 113 (1861).

["The lien of the carrier by water for his freight, under the ordinary bill of lading, although it is maritime, yet it stands upon the same ground with the carrier by land, and arises from his right to retain possession until the freight is paid, and is lost by an unconditional delivery to the consignee. It is suggested in the argument for the appellant that, as a general rule, maritime liens do not depend on possession of the thing upon which the lien exists; but this proposition cannot be maintained in the courts of admiralty of the United States. And, whatever may be the doctrine in the courts on the continent of Europe, where the civil law is established, it has been decided in this court that the maritime lien for a general average in a case of jettison, and the lien for freight, depend

upon the possession of the goods, and arise from the right to retain them until the amount of the lien is paid. (*Rae v Cutler,* 7 How. 729; *DuPont de Nemours & Co v Vance and others,* 19 How. 171.)"

". . . After these two decisions, both of which were made upon much deliberation, the law upon this subject must be regarded as settled in the courts of the United States, and it is unnecessary to examine the various authorities which have been cited in the argument."]

Cranston v. 250 Tons of Coal, 22 Fed. 614, 615 (D.C. N.J. 884).

["Some maritime liens may be enforced . . . by parties who never were in possession; but this is not the nature of the ship-owner's or master's lien upon the cargo for his freight. His right depends upon his detention of the goods until the payment is made. If he parts with them voluntarily and without notice that he looks to them for the freight and charges against them, he loses all right to enforce a lien upon them by a proceeding *in rem.* A different rule is recognized by the courts of continental Europe, but this is the well-established doctrine in admiralty of the Supreme Court of the United States."].

Cutler v. Rae, 48 U.S. 374, 376; 7 How, 729 (1848).

["But it is otherwise in general average. The party entitled to contribution has no absolute and unconditional lien upon the goods liable to contribute. The captain has a right to retain them until the general average with which they are charged

has been paid or secured. And as he may do this for the security of the party entitled, he must be regarded as his agent in this respect, and exercising his rights. This right of retainer, therefore, is a qualified lien, to which the party is entitled by the maritime law. *But it depends on the possession of the goods by the master or shipowner, and ceases when they are delivered to the owner or consignee. It does not follow them into their hands, nor adhere to the proceeds.*" (emphasis ours)].

See also:

DuPont, Etc., Co. v. Vance, et al., 60 U.S. 162, 171 (1856);

Wellman v. Morse, 76 Fed. 573 (1st Cir. 1896).[9]

Since the lien of a shipowner (which is the lien asserted in the case at bar) is possessory and limited to the cargo, it does *not* attach to the proceeds of cargo. Libelant's assertions to the contrary are disposed of by the foregoing authorities and the decision in *Portland Flouring Mills v. Portland, Etc., S.S. Co.,* 145 Fed. 687 (D.C. Ore. 1906)[9a] The *Portland* case involved a complicated set of facts which may be summarized as follows: The libelant there was a shipper of cargo of flour which had been transported by means of

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[9]In part I we are conceding, *arguendo,* the existence of a possessory lien upon cargo and demonstrating that it does not follow and adhere to proceeds. However, as we discuss in Part IV, *infra,* even the possessory lien does not exist since it was waived by the issuance by Compania of "freight prepaid" bills of lading.

[9a]There are two decisions relative to this case—the later decision is cited in footnote 7, *supra.*

the charter of a ship owned by the respondent. The freight was to have been paid to respondent by the consignee. After the voyage started the ship ran aground and the cargo was salvaged. The proceeds of the salvage (monies) were paid to the respondent (shipowner). The libelant, however, was compelled to pay the freight for the shipment to the insurance carrier for the respondent since the same could not be collected from the consignees. The libelant then brought the subject action against the shipowner, claiming that since it had paid the freight it was subrogated to the lien claims of the respondent shipowner to the cargo and to the proceeds of cargo, *i.e.*, the salvage money. (145 Fed. at 690-691).

The respondent in *Portland* filed exceptions and the opinion involved the determination of the same. The court noted (p. 691) that since the theory of the libelant was one of subrogation, for the libelant to prevail it must establish a right of subrogation and that the shipowner (to whose rights libelant sought to be subrogated) had a lien on the cargo or the proceeds.[10] Thus, the basic question for decision in *Portland*, as here, was whether the shipowner had a lien on the cargo of flour and whether that lien continued to attach to the proceeds of the cargo.

In *Portland* the court held that the shipowner's lien, being solely possessory, did *not* extend beyond the possession of the cargo and that there could be no attachment of the lien to the proceeds of the cargo. The

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[10]The court noted: "The lien relied upon, through which subrogation is claimed, is the shipowner's lien for freight for the carriage of goods. Such lien depends upon possession, and its preservation upon a continuance of possession." (p. 691).

court made the following statement which is dispositive of libelant's contentions in the case at bar:

> "Such being the nature of the lien that the Portland and Asiatic had upon the flour for the freight charges, and such its right and obligations, it not only waived its lien, as it had a right to do, but it lost it absolutely when it abandoned the cargo to the underwriters, as it thereby surrendered possession, thus depriving itself of an essential in the retention of such lien. *The lien being lost, the alleged fact, which must be taken as true, that the proceeds of the salvaged flour came into the Yokohama Specie Bank to the joint credit of the agents of the Portland and Asiatic and the assurance company, could not be effective to restore it, so that there is no lien upon such proceeds, into whosoever hands they have come.*" (emphasis ours) 145 Fed. at p. 694.

In the case at bar the assertion made by libelant that its lien on cargo attaches to proceeds of cargo is exactly the assertion made and rejected in *Portland*. The possessory lien of libelant is limited to cargo and does not attach to proceeds. This being so, even if the funds paid to respondent Bank are deemed proceeds of cargo, there could be no lien thereon in favor of libelant. [See also: *N. H. Shipping Corp. v. Freights of the S.S. Jackie Hause,* 181 F. Supp. 165 at p. 169 (S.D. N.Y. 1960), where the court states that the shipowner's lien on cargo "depends on possession of the cargo and is lost by unconditional surrender to the consignee."]

The maritime law which grants to the shipowner a possessory lien on cargo is designed to substitute the cargo as security for the payment of the charter hire

in the place of the personal credit of the charterer or any other remedy that the shipowner may have. This point is further emphasized here by the fact that the charter party herein involved (Ex. 1) contains a partial "Cesser Clause."[11] The subject clause involved here reads:

> "Owners shall have a lien on cargo for freight, dead freight, demurrage. Charterer shall remain responsible for dead freight and demurrage (including damages for detention) incurred as part of loading. Charterer shall also remain *responsible for freight and demurrage incurred at port of discharge, but only to such extent as the owners have been unable to obtain payment thereof by exercising the lien on the cargo.*"[12] [Charter Party, Ex. 1, Par. 8 (emphasis ours).]

Thus, by agreement libelant agreed to look first and exclusively to its possessory lien upon cargo for payment of freight due it and released the charterer (Kenray) from all liability for freight, except to the extent that there might be a deficiency resulting from the cargo being insufficient to satisfy the freight claim. This contractual limitation demonstrated libelant's intent to limit its remedies to the exercise of its pos-

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[11]A "Cesser Clause" is one which terminates the personal liability of the charterer for freight once the ship is loaded and substitutes for such personal liability the shipowner's lien upon the cargo. [See Gilmore & Black, *op. cit.*, p. 190; Robinson, *Admiralty Law* (1939) pp. 637-641.]

[12]It is to be noted that this lien clause refers only to the owner (libelant) having a lien on "cargo" and makes no reference to any lien on subfreights. The absence of any provision granting a lien on subfreights is important, the significance of which is discussed in Part II, *B, infra*, dealing with the libelant's assertion that it has a lien on the attached monies as "subfreights".

sessory lien on cargo. Libelant here admittedly had ample opportunity to exercise that lien on cargo but voluntarily chose not to do so. Having failed to do so, and having no personal claim against the charterer (Kenray). it would be the height of inconsistency to permit libelant to reach funds attached in the possession of respondent Bank.

> [Cf. *Todd Shipyards Corp. v. City of Athens,* 83 F. Supp. 67, 81-82 (D.C. Md. 1949) Aff'd on other grounds *sub nom. Acker v. City of Athens,* 177 F. 2d 961 (4th Cir. 1949) where court held lien of shipyard subordinate to liens of voyage where ship permitted to leave shipyard without seizure - court noting that shipyard had voluntarily released a favored position.]

It is, of course, clear that regardless of the presence or absence of a "cesser clause" the shipowner's *lien* (as distinguished from its *in personam* claim against Kenray) is limited to the right to retain possession of the cargo and is lost upon surrender of the cargo. The existence of a cesser clause, however, demonstrates a contractual intent to limit libelant's remedies in the event of nonpayment of charter-hire to that possessory lien.

In the case at bar the District Judge concluded that the surrender by Compania of the Searaven's cargo to the consignees did not discharge its lien in that prior to the surrender Compania had commenced this suit and attached the monies in the hands of the Bank.[13] To reach that conclusion the District Judge relied upon the decision in *N. H. Shipping Corp. v.*

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[13][R. 226, Concl. 4; R. 196-197, Opinion pp. 1-6].

Freights of the S.S. Jackie Hause, supra, 181 F. Supp. 165 (S.D. N.Y. 1960). We respectfully submit that such reliance is misplaced and is not a correct interpretation of the *Jackie Hause* decision. In *Jackie Hause,* prior to the delivery of the cargo to the consignee the shipowner asserted a claim for unpaid charter hire; unlike the case at bar, however, the consignee had not yet paid the charterer or its assigns and the consignee still retained the freight monies which it had agreed to pay upon delivery. When the claims of the shipowners were asserted, by express contractual agreement, the monies due from the consignee were deposited in an escrow and the cargo released to the consignee. It was thereafter argued that the release of the cargo discharged the shipowner's lien. The court, in *Jackie Hause,* rejected that argument, but not for the reasons assumed by the District Judge here; the court in *Jackie Hause* recognized the general principle that a shipowner's lien is dependent upon possession, but found that the freight monies were substituted for the cargo by the consignees upon an express agreement and therefore there was no unconditional release of the cargo. Such is not the case here. In the case at bar, there was no express agreement substituting the proceeds for the cargo, and the proceeds here were not in the possession of the consignees but had been *prepaid* to respondent Bank by means of the letters of credit. The filing of a lawsuit here cannot be equated with the contractual substitution made in *Jackie Hause. Jackie Hause* did not involve prepaid freights as does the matter at bar [See Part II, *infra*]; nor did it involve an unconditional release of cargo such as is present here, but rather was a case where the owner would not release the cargo until the proceeds were deposited.

Furthermore, the court in *Jackie Hause* was not concerned with "freight prepaid" bills of lading such as those issued by Compania, the issuance of which constituted a waiver of any lien at the time of issuance—which was substantially prior to the filing of this suit. [See Part IV, *infra*].

If the decision of the District Judge here were correct, it would entirely obviate the recognized rule, acknowledged in *Jackie Hause,* that the shipowner's lien depends on possession, for the reason that the shipowner could then ignore the cargo and the contractual claim against the charterer and simply proceed against third persons to whom the charterer caused the proceeds to be paid. Such a result is entirely incompatible with long accepted admiralty law. The *Jackie Hause* decision would be applicable here only if Compania had asserted a lien before the consignees *paid* respondent Bank. That was not done; therefore, Compania was limited to a possessory lien on the cargo which it surrendered, and that lien cannot be reinstated and attach to the monies paid to the Bank.

B. Even if the Shipowner's Lien Attached to Proceeds of Cargo (Which It Does Not) the Lien Cannot Be Traced to Funds in the Hands of Third Persons.

If the court were to hold (contrary to the authorities contained in Part A, *supra*) that the shipowner's lien on cargo extended to proceeds of cargo, it does not follow that the lien could apply to those proceeds after they have passed into the hands of a person other than the charterer.

It is established law that maritime liens are *stricti juris,* are to be narrowly construed and *may not be extended by construction, analogy or inference.*

Osaka Shosen Kaisha v. Pacific Export Lumber Co., 260 U.S. 490, 499 (1923);

Vanderwater v. Mills (*Yankee Blade*), 60 U.S. 82, 89 (1856);

State v. A/S Nye Kristianborg, 84 F. Supp. 775, 777-778 (D.C. Md. 1949) and cases collected.

The Supreme Court, in *Kaisha, supra*, refused to extend the maritime lien for breach of an executory contract to carry cargo and articulated the rule as follows:

> "The maritime privilege or lien, though adhering to the vessel, is a secret one, which may operate to the prejudice of general creditors and purchasers without notice, and is therefore *stricti juris,* and cannot be extended by construction, analogy or inference." (260 U.S. at p. 499).

At no stage of this case have counsel for libelant cited any authorities which permitted the imposition of a shipowner's lien upon proceeds of cargo, much less proceeds which have passed into the hands of a third person.[14] The District Court's entire concept of im-

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[14]The cases cited below by libelant to support its "tracing" theory did not involve a shipowner's lien [e.g., *The Surico*, 42 F. 2d 935 (W.D. Wash. 1930)] and involved funds which were still in the hands of the charterer [*Bank of British No. America v. Freights of Hutton & Ansgar*, 137 Fed. 534 (2nd Cir. 1905)]. In the latter case, which contains the "tracing" language relied on by libelant, no shipowner's lien was involved and the court expressly relied on the fact that the funds were in the charterer's bank account (137 Fed. at p. 537). *The Surico* involved nonpossessory liens asserted by stevedores. These and other cases cited by libelant are discussed in more detail in Part II, *infra.*

posing a lien upon the attached funds in the hands of respondent Bank is based on the *extension* of existing lien rights—a result not permitted under maritime law. If it is assumed, *arguendo,* that the monies attached were proceeds of cargo susceptible to a lien while in the hands of the consignees of the cargo or the charterer (Kenray), it still does not follow that the lien would apply once the monies are paid by the consignees or charterer to third persons and there is no known authority so holding. The result urged by libelant is unsupported by any authority and no lien can be applied. [*Osaka Shosen Kaisha v. Pacific Export Lumber Co., supra.*]

II.

The Attached Funds Were Not Subfreights Upon Which Libelant Had a Lien. Even if Libelant Had Such a Lien It Was Discharged Upon Payment of the Funds to Respondent.

As we have demonstrated in Part I, *supra,* the judgment here cannot be sustained upon the theory that the attached funds represent proceeds of cargo to which libelant's possessory lien on cargo attaches. Libelant asserts, then, that the attached funds represented subfreights, i.e., freight monies due to the charterer Kenray from third party shippers of goods,[15] and that the lien can be traced to the funds after they were paid to and received by respondent Bank.

To sustain this latter contention libelant must establish, as a matter of law, three essential elements of its claim, the absence of any one of which destroys

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[15]"Subfreights" are so defined in Gilmore & Black, *op. cit.,* p. 208. As the context requires, the word "freights" is sometimes used to denote subfreights in the reported decisions.

the asserted lien. These elements are: (1) That the funds in the first instance, prior to payment to respondent, represented subfreights; (2) that under the terms of its charter party libelant had a lien on subfreights; and (3) that the lien, if it existed initially was not destroyed by the payment of the alleged subfreights either to Kenray or to respondent Bank prior to the time the lien was asserted. As we will now document, all three of these elements are lacking in the case at bar.

A. No Portion of the Funds Paid to Respondent Bank Upon the Letters of Credit Are Clearly Identifiable as Subfreights.

The funds paid to respondent were paid pursuant to drafts drawn by Kenray against nine letters of credit. These letters of credit were issued by foreign banks at the instance of the purchasers-consignees of the cargo of scrap to secure to Kenray the payment of purchase price of the scrap. The drafts drawn by Kenray in favor of respondent against these letters of credit represented such purchase price and the payment of the drafts was payment of the price of cargo.[16] The pay-

[16]Letters of credit are, of course, the long accepted means of arranging payment for the purchase of goods in international transactions. They usually provide, as they do here, for payment by the issuing banks of drafts drawn against the letters upon presentment of the drafts accompanied by the designated documents showing the specified goods to have been shipped. The purposes of a letter of credit are (1) to substitute the established credit of a bank (foreign or domestic) for the personal liability of the buyer, and (2) provide a sure, effective and convenient way of payment of the purchase price. [See generally *7 Am. Jur. Bills & Notes*, §224, pp. 917-920; *Gilmore & Black, op cit.*, Chapter 3.] The drafts drawn by Kenray were as though Kenray had drawn checks in favor of respondent against funds on deposit in the foreign banks. The payment of the drafts was payment of the purchase price to Kenray and, in turn, payment from Kenray to respondent.

ments and the letters of credit were in lump sums, with *no allocation* of any portion thereof to freight charges [Exs. 4A-4I]. The absence of any such allocation precludes the funds or any portion thereof from being deemed subfreights.

Subfreights are monies which are owed by a third party shipper to the charterer as compensation for the carriage of cargo and which are specifically stated and indicated to be for such carriage. [*Gilmore & Black, op. cit.,* p. 208; *Scrutton on Charter Parties* (15th Ed.) p. 366; *American Steel Barge Co. v. Chesapeake & O. Coal Agency,* 115 Fed. 669, 672 (1st Cir. 1902); *United States v. Freights, Etc., S. S. Mt. Shasta,* 274 U.S. 466 (1927).][17] In the case at bar, no part of the $535,-371.27 received by respondent in payment of the drafts was indicated specifically to be in payment of freight but rather said sum was simply a lump sum payment for the goods purchased. Consequently, it cannot be said that there were any subfreights involved to which a lien in favor of the shipowner could apply. There being no specific subfreights, libelant's asserted lien must fall.[18]

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[17]*Scrutton on Charter Parties* states that freight (or, in this instance, subfreight) is ". . . the reward payable to the carrier for the carriage and arrival of the goods in a merchantable condition, ready to be delivered to the merchant." Subfreight, in the context of a charter party, is the amount owing from a shipper to the charterer as freight. In *American Steel Barge,* the court said that subfreights "embrace all freights which a *charterer* stipulates to receive for the carriage of goods, whether he takes the ship by demise or otherwise".

[18]It is not disputed that Kenray received from Purdy International Corp. the additional sum of $9,980.20 as payment for the carriage aboard the Searaven of goods sold by Purdy. This sum was deposited by Kenray into its commercial checking account with respondent Bank, and subsequently set-off upon Kenray's in-

(This footnote is continued on the next page)

Libelant argued below that the court should *infer* that a portion of the $535,371.21 received by libelant is subfreight because the consignees required the shipments to be C.I.F., i.e., a lump sum for cost of goods, insurance and freight. The District Court made such an inference and based thereon found that the sum of $96,750.00 should be allocated as reasonable subfreights and carved out of the monies received by the Bank.[19] That result cannot be sustained:

First, to make such an inference, the Court was required to deviate from the long accepted principle that liens in admiralty proceedings are *stricti juris* and may not be extended by inference, analogy or construction.

> E.g., *Osaka Shosen Kaisha v. Pacific Export Lumber Co., supra,* 260 U.S. 490, 499 (1923); *Vanderwater v. Mills, supra,* 60 U.S. 82, 98 (1856).

Second, there was no evidentiary basis for determining what portion of the $535,371.21 was to be allocated as subfreights. It was speculation to assume any portion thereof attributable to freight, just as it would be speculation to assume any portion allocable to the cost of insurance, the cost of the goods themselves, the cost of Kenray's overhead or the cost of any other item of expense that goes into a package sale. The sale here was a lump-sum price and it is equally (if not more) inferable that Kenray, in order to make the total deal, was itself absorbing the cost of the freight.

Third, in a C.I.F. contract, the obligation for the payment of freight is that of the *seller-shipper* (Ken-

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debtedness. We concede that said sum of $9,980.20 was subfreight; we would not concede however, that there is any lien thereon (See Parts B and C, *infra*).

[19] [R. 224, Find. 20; R. 197, Opinion p 6.]

ray) and not that of the consignees. The consignees in such a contract are obligated to pay nothing on account of the transportation charges [*Warner Bros. & Co. v. Israel,* 101 F. 2d 59, 61 (2nd Cir. 1939); *Calif. Commercial Code,* Sec. 2320]. This being so, there is nothing due or owing from the consignees to the charterer (Kenray) for transportation charges—there being nothing due to the charterer for transportation costs, there are no subfreights.

To support the conclusion that $96,750.00 was here to be allocated as quasi-subfreights even though Kenray was both charterer and shipper, the District Judge relied upon *Whitney v. Tibbol,* 93 Fed. 686, 688 (9th Cir. 1899) and similar decisions cited below, all of which involved liens for seaman's wages.[20] For several reasons, those cases have no application here:

First, as noted, the cited decisions all involved an assertion of a lien for unpaid seaman's wages. None of the cases involved a contractual shipowner's lien granted under the terms of a charter party such as that asserted in the case at bar. A seaman, unlike a shipowner, has *no lien upon cargo* but is limited to a lien on the vessel or upon its freights. [See cited decisions and also 1 *Benedict on Admiralty* (6th Ed.), Section 80, page 249.] Therefore, a seaman may ordinarily not assert a lien upon cargo for unpaid wages. In the cited cases (which refer to situations where the owner of the cargo was also the owner or charterer of the ship so that there was no freight money available for the seaman's lien) what was done to protect the

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[20]*Poland v. The Spartan,* 19 Fed. Cas. No. 11246 (D.C. Maine 1828); *Clifford v. Merritt-Chapman & Scott Corp.,* 57 F. 2d 1021 (5th Cir. 1932); and *Vlavianos v. The Cypress,* 171 F. 2d 435 (4th Cir. 1948).

seaman was to designate a "reasonable freight" and then allow the seaman to assert a lien in such amount *directly against the cargo.* Thus, the cases do not involve a situation where freight is "carved out" so as to permit the assertion of a lien against the freight money, but rather involve the assertion of a lien against cargo to the extent of a reasonable allowance for freight. To designate reasonable freight, so as to allow the assertion of a lien against cargo (as was done in the seaman cases) is substantially different from designating a sum as freight and allowing a lien directly against that sum as the District Judge did here. In the case at bar libelant is not attempting to assert a lien against cargo to the extent of reasonable freight (i.e., the seaman's lien cases) but is rather attempting to assert an independent lien against freights or proceeds. The seaman's cases are therefore not in point. Libelant has cited no authority where freight, in a situation such as that existing in the case at bar, was implicitly established for the benefit of a shipowner.

Second, the seaman's cases are also not applicable in that the seaman's lien is a preferred maritime lien [See *Robinson on Admiralty,* pages 286, 369; Gilmore and Black, *The Law of Admiralty,* pages 514, 596], whereas the owner's lien (which is the lien involved herein) is created solely by the contractual provisions of a charter party. In the cited cases the court permitted the seamen to lien the cargo to the extent of unpaid freight in order to avoid a total absence of remedy for the seaman. Here, libelant had a remedy since it had a direct lien on cargo and there is no need for the creation of an indirect lien.

In summary, there is no basis upon which it can properly be concluded that any portion of the $535,-371.21 paid to respondent represented subfreights and, accordingly, there is nothing to which the alleged lien could apply.

B. The Charter Party Does Not Grant to Libelant a Lien on Subfreights.

Assuming that the court sustains the finding of the District Court that $96,750.00 of the monies received by respondent Bank should be "carved out" as subfreights, libelant must then demonstrate that it had a lien upon subfreights in the first instance.[21] If there initially was no lien on subfreights in favor of libelant, then there need be no consideration of the extent or duration of that lien or the loss thereof by actual payment of the subfreights prior to assertion of the lien [Part *C, infra*].

It is established admiralty law that a shipowner does not have a lien upon subfreights owed to a charterer *except as a result of an express grant in the charter party relating to the charter of the vessel earning the subfreights.*

In re No. Atlantic & Gulf S.S. Co., 204 F. Supp. 899, 904, 906 (S.D. N.Y. 1962) aff'd *sub nom Schilling v. A/S D/S Dannebrog,* 320 F. 2d 628 (2nd Cir. 1963). [Court stating: "Shipowner's liens on earned subfreights due to a charterer are based on an ancient and standard charter provision,

[21]Our point in Part *A, supra,* is that there are no identifiable subfreights. In Parts *B* and *C* we assume to the contrary that the inferential finding of the District Judge is sustained and demonstrate that the Judgment must nevertheless be reversed as a matter of law.

the origins and history of which are somewhat obscure. It is clear, however, that no such lien can arise without an express grant in the charter of the vessel earning the subfreights . . . The lien cannot arise unless there is a specific lien clause written into the charter party." (204 F. Supp. at 904) and "Liens on subfreights derive entirely from some specific provision in the charter of the vessel and have no basis other than that." (204 F. Supp. at 906)][22]

Ocean Cargo Lines v. No. Atl. Marine Co., 227 F. Supp. 872, 880 (S.D. N.Y. 1964) [Court stating: "A shipowner's lien on earned subfreights owing to a charterer depends upon the inclusion of a specific lien clause in the charter of the vessel earning the subfreights."]

See also:

Hall Corp. v. Cargo ex Steamer Mont Louis, 62 F. 2d 603, 605 (2nd Cir. 1933) and cases collected;

Actieselskabet Dampsk, Thorbjorn v. Harrison & Co., 260 Fed. 287, 290 (S.D. N.Y. 1918);

Gilmore & Black, op. cit. p. 517, note 103 and cases collected;

Poor, *Charter Parties and Bills of Lading*, (4th Ed. 1948) p. 46.[23]

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[22]In the cited case, the charter did contain a provision for a lien on subfreights. The pertinent provision of the charter was ". . . owners shall have a lien upon all cargoes, and all subfreights . . ." (204 F. Supp. at 904). This clause differs substantially from the lien clause in the case at bar (*infra*).

[23]The author states: "Much litigation has arisen respecting the effect of giving the owner a lien upon cargoes and subfreights. Without an express clause giving a lien none would exist . . . If the owner wishes to retain his lien he should expressly contract to that effect."

The charter party involved in the case at bar (Ex. 1) contains *no provision* for a lien on subfreights. The lien reserved therein is by agreement limited to a lien on cargo. The subject provision (Par. 8) reads in pertinent part as follows:

> "Owners shall have a lien on the cargo for freight, dead-freight demurrage . . ."

Since the lien provision herein makes no reference to a lien on subfreights there can be none. This being so, the *in rem* claims of libelant must fail even if any portion of the funds attached are deemed subfreights.

In making this argument that the subject charter party makes no provision for a lien on subfreights, we are not unmindful of the statement made in *N. H. Shipping Corp v. Freights of the S. S. Jackie Hause,* 181 F. Supp. 165 at 170 (S.D. N.Y. 1960) upon which the Court below relied, that a lien on cargo is a lien on freights, but we believe that decision not to be controlling here for several reasons: (1) The statement of the District Court in *Jackie Hause* is in conflict with other opinions of the Second Circuit (cited above) that there must be a specific reservation in the charter of a lien on subfreights; (2) *Jackie Hause,* in making the statement, relied upon *Jebsen v. A. Cargo of Hemp,* 228 Fed. 143 (D.C. Mass. 1915) which upon analysis was a case involving a lien asserted against cargo and not against subfreights; (3) The facts in *Jackie Hause,* unlike those in the case at bar, were that the cargo was conditionally discharged and the freight monies impounded by agreement of the parties in lieu of cargo—so that there was a contractual substitution of freight monies for cargo—in this regard, the District Judge in *Jackie Hause* noted (at p. 170) that the limitation of

the lien in the charter party to cargo "might be significant under other circumstances"; and (4) *Jackie Hause* in fact did not involve subfreights as such since the owner there was in direct privity with the consignee by reason of the substitution of a vessel other than that originally under charter. *Jackie Hause* is therefore distinguishable upon these grounds and not controlling here. Consequently, under the charter party herein, there is no lien upon subfreights.

C. Any Lien on Subfreights That Libelant May Have Had Was Discharged Once the Subfreights Were Paid to Respondent or to Kenray.

Assuming, *arguendo*, that this court sustains the conclusion that $96,750.00 of the attached funds are identifiable sub-freights and that libelant had a lien on subfreights under the provisions of the charter party, we reach the crucial substantive question of whether that lien was lost and discharged when the subfreights were paid to Kenray or to respondent.[24] We submit that it is beyond dispute that the lien was so lost and discharged.

The admiralty decisions are unequivocal that where a shipowner has a lien upon subfreights such lien is *lost and discharged once the subfreights are paid*—that is, the lien is valid only so long as the subfreights are *owed* to the charterer or its successor and *if the sub-*

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[24]That the alleged subfreights have been paid by the consignees is undisputed. It was stipulated and found that the proceeds of the letters of credit were paid by the consignees when Kenray drew drafts in favor of respondent against the letters. The Purdy subfreights were paid by Purdy to Kenray, deposited and then set off.

freights are paid before the shipowner asserts its lien, the lien is lost forever.

In re North Atlantic & Gulf Steamship Co., supra, 204 F. Supp. 899, 904 (S.D. N.Y. 1962) aff'd *sub nom Schilling v. A/S D/S Dannebrog,* 320 F. 2d 628 (2nd Cir. 1963);

Hall Corp. v. Cargo ex Steamer Mont Louis, 62 F. 2d 603, 605 (2nd Cir. 1933);

American Steel Barge Co. v. Chesapeake & O. Coal Agency, 115 Fed. 669, 676 (1st Cir. 1902);

Poor, op. cit., p. 48;

Stephens, on Freight, p. 200;

Gilmore & Black, op. cit., p. 208 and cases collected.[25]

In the *No. Atlantic* case, *supra,* the rule is stated as follows:

> "The shipowner's lien on subfreights permits him to obtain payment of monies due under the charter out of such subfreights earned by the vessel as remain *unpaid* by a shipper to the charterer (authority) . . . *If the cargo is delivered and the shipper pays the subfreights to the charterer in good faith, the shipowner's lien falls* (authority)." (emphasis ours) (204 F. Supp. at 904)

In *Poor, supra,* the author states:

> "Once the freight has been paid over to the person entitled to receive it, it loses its character as freight and is no longer subject to a lien."

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[25]See also: *The Mt. Shasta,* 274 U.S. 466, 471 (1927) where the court, in sustaining *in rem* jurisdiction, indicated that the question of whether there were any subfreights "due" from the third-party shipper was to be determined upon trial.

Gilmore & Black, at p. 208, state the rule as follows:

> "The [Charter-party] provisions for liens on cargo and subfreight can apply only when there is freight actually owing on a shipment of goods; payment in the ordinary course to the charterer by the third-party shipper discharges the latter's obligation and with it the lien."

The rule is stated in *Stephens, on Freight, supra,* as follows:

> "But such a lien can only be exercised before the subfreight has been paid to the charterer of the ship or his agent. The *lien confers no right on the shipowner to follow the subfreight after it has been paid.*" (emphasis ours).

It is significant that the foregoing authorities speak in terms of the lien "falling" or being "discharged" upon payment of the subfreights and that the owner may not "follow" the monies. Since the lien is discharged (and not merely subordinated) it is immaterial whether the controversy is between the owner and the consignees or between the owner and any other party. Once the subfreights are paid there is no longer any lien. It is also significant that the authorities make it clear that the lien on subfreights falls when the monies are paid to the charterer; it would follow, then, *a fortiori,* that the lien also falls when the monies are paid to a third party such as respondent Bank who has no contractual relationship with the owner; if, as appears from the authorities, the lien falls and is discharged upon payment, no question of tracing or priorities arises because there simply is no lien to trace.

It is clear from the foregoing authorities that if Compania were to assert a lien on subfreights, it was

required to do so while the subfreights remained unpaid, that is, in the hands of the third party shipper (Purdy) or the Taiwan consignees. It could have asserted such lien by libeling or attaching the subfreights while they remained unpaid or even by giving appropriate notice to the consignees before payment was made.[25a] Compania failed to assert a lien before payment and may not now do so.

Further supporting the result that a shipowner is not entitled to a lien on subfreights which were prepaid to the charterer are the admiralty cases where it has been held that a mortgagee of a ship and its freights acquires no rights to freights which have been received by the mortgagor or its assigns before possession is taken by the mortgagee.

E.g.

Layne & Bowler v. U.S. Shipping Board, 27 F. 2d 39, 41 (9th Cir. 1928);

Merchants Banking Co. v. Cargo of Afton, 134 Fed. 727, 728 (2nd Cir. 1904).

The analogy between a mortgagee of a ship who is not in possession and the owner where there is a char-

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[25a]On this point, innumerable common-law analogies come readily to mind. *E.g.*, the requirement that a garnishment be levied *before* the garnishee makes payment to the defendant; the giving of notice of the assignment of an account receivable *before* payment is made by the obligor to the assignor; the recordation of a mechanic's lien within the statutory time; the giving of notice of an assignment of a judgment *before* payment of the judgment is made. A most appropriate analogy is to a mortgagee of real property who is not in possession - that mortgagee has an inchoate lien on the rents derived from the property but the lien does not reach rents paid by the tenants to the mortgagor before the mortgagee exercises his lien by appropriate notice or proceedings. [See *Malsman v. Brandler,* 230 Cal. App. 2d 922, 923-924 (1964).]

ter is obvious and in either case the lien holder has no claim to freights paid before the lien is asserted. That analogy has been noted by this Court. [*Schirmer Stevedoring Co. Ltd. v. Seaboard Stevedoring Corp.*, 306 F. 2d 188, 192 (9th Cir. 1962)].

Libelant has cited no case (and we know of none) sustaining a shipowner's lien on subfreights where the subfreights have been paid to the charterer prior to assertion of the shipowner's lien. This being so, the District Court erred in going even farther by applying a lien on funds which have passed out of the possession of the charterer.

The theory of the shipowner's lien on subfreights is that the shipowner is contractually subrogated (under the lien clause of the charter agreement) to the charterer's right to receive payment of the subfreights. [See [*American Steel Barge Co. v. Chesapeake & O. Coal Agency, supra,* 115 Fed. at 674.] Once the subfreights are paid, however, there is no longer anything to which the lien can attach or to which the owner can be subrogated.

That the lien is lost regardless of whether the subfreights are paid to the charterer (Kenray) or paid to a creditor of the charterer (respondent Bank) is demonstrated by one aspect of the decision in *In re North Atlantic & Gulf Steamship Co., supra.* One of the issues in that case (discussed at 204 F. Supp. 906) was whether certain attachments of earned (and unpaid) subfreights which had been levied by creditors of the charterer were tantamount to payment of the subfreights so as to defeat the lien of the shipowner. The court held that had the creditors obtained a judgment against the charterer and satisfied the same out of the

funds attached "plainly the shipowner's lien would be lost." Thus, the court held that if a creditor of the charterer *receives* the subfreights the shipowner's lien is discharged. The court went on to point out that the attachments themselves would have been sufficient to defeat the shipowner's lien except that they were voidable as having been obtained within four months of the charterer's bankruptcy and hence not perfected.[26] The teaching of the case is clear: If a creditor of the charterer perfects the right to receipt of the subfreights before the shipowner's lien is asserted (and *a fortiori* if the creditor actually receives them) the shipowner's lien falls. Such is the case at bar.

The authorities which libelant cited below in support of its contentions do not support the existence of a lien in its favor upon the attached funds which were in the possession of respondent Bank. *Bank of British No. America v. Freights etc. of Hutton and Ansgar,* 137 Fed. 534 (2nd Cir. 1905) did not involve the assertion (as here) of a lien by the shipowner; in *Ansgar* the issue was whether a Bank, which had received from the charterer of a ship an assignment of freights, could prevail over the charterer's administrator with respect to freights which had been received and deposited into the charterer's account; the court held in favor of the bank. *Ansgar* was a case which not only was unrelated to shipowner's liens, but also involved disputes between the contracting parties

[26]The cited case was decided in the context of Chapter X bankruptcy proceedings. In the case at bar the payments to respondent Bank were clearly perfected and there are no bankruptcy proceedings involved. The *North Atlantic* case, then, involved not only the question of the shipowner versus consignees, but also the shipowner versus creditors of the charterer who may have perfected receipt of the subfreights.

and not third parties. While the case does speak of tracing of liens, it does so in the context of a non-shipowner's lien and with respect to funds which were still in the possession of the charterer and had not been paid to third persons; furthermore, in *Ansgar* the court made an express finding, upon which it based its holding, that there was an agency agreement which obligated the charterer to collect the funds for the benefit of the bank. The court clearly indicated (at p. 537) that the Bank's lien applied so long as the funds were in the hands of the charterer or in his bank account—the case does not support a tracing of any lien to funds passing into the hands of third persons, especially where, as here, that third person is not in privity with the lien claimant. Thus, the case is inapplicable not only because it does not involve a shipowner's lien (which by law is lost on payment of the subfreights) but also because it involved funds still in the possession of the charterer which were required by agreement to be held by the charterer for the benefit of the bank.

The Surico, 42 F. 2d 935 (W.D. Wash. 1930), also cited below by libelant, also did not involve a shipowner's lien. In *Surico* the lien was that of a stevedore and the holding of the case was that the stevedore's lien could not be defeated by novation agreement between the shipowner and the charterer. In *Surico* the court was not concerned with the lien of a shipowner or the tracing of monies into the hands of a third party not in privity with the charter party agreement; the stevedore lien there was asserted to monies still in the hands of the parties to the charter agreement and the case has no factual similarity to the matter at bar. The lien involved in *Surico*, being for stevedoring charges,

was that of a maritime supplier and, hence, a non-possessory lien. It did not involve, as here, the rights of the shipowner to cargo or subfreights.

Freights of the Kate, et al., 63 Fed. 707 (S.D. N.Y. 1894) relied upon by Compania, involved a case where the freights had not yet been paid to the charterer and the assignment thereof remained completely executory, both in the sense that it was on unearned freights and that the freights were unpaid to the charterer or its assignee at the time of the assertion of the shipowner's lien. Hence, the case is of no support to libelant here. The subfreights in the *Kate* had in fact subsequently been collected by the shipowner and deposited by the shipowner in court subject to the order of the court. The *Kate* would be helpful to Compania only if it had asserted its lien against the alleged subfreights of the Searaven before they were paid to Kenray or to respondent. The court in *The Kate* specifically noted that the assignee of the freights had not received *payment* thereof (see discussion p. 712), and was therefore passing upon executory rights as distinguished from a lien asserted against prepaid freights.

The case of *N. H. Shipping Co. v. Freights of the S. S. Jackie Hause,* 181 F. Supp. 165 (S.D. N.Y. 1960) which we have previously discussed in part, was the principal authority cited below by libelant and was strongly relied upon by the District Judge in reaching his result. The case does not sustain the judgment. Insofar as that decision dealt with subfreights the case is distinguishable in that the monies owed by the consignee were clearly for the shipment of cargo (and not, as here, a lump-sum purchase price) and the subfreights had not been paid by the consignee but had been *impounded*

pending trial. The court noted that the impounding of the subfreights had been an express condition of the release of the cargo to the consignee (also a fact not present here) and that this conditional delivery was the fact which prevented the shipowner's lien from being discharged (p. 171). In the case at bar there was not, and could not have been, such an impounding since any funds due from the consignees of the Searaven's cargo had been *prepaid* before Compania's lien was asserted. There is also a major question in *Jackie Hause* of the validity of the assignment of the freights because of the substitution of vessels (see discussion 181 F. Supp. at p. 170); therefore the case is distinguishable upon that further ground even if libelant were correct (which it is not) that in determining priorities an executory assignment of freights is to be equated with actual payment thereof. A creditor of the charterer who has received actual payment of the subfreights prior to assertion of the shipowner's lien by appropriate process (as distinguished from an executory assignment thereof) takes priority over the alleged lien of the shipowner since the shipowner's lien, as a matter of law, has ceased from the moment of payment. [*In re North Atlantic & Gulf Steamship Co., supra*, 204 F. Supp. at 906.][27]

American Smelting & Refining Co. v. Naviera Andes Peruana, S.A., 208 F. Supp. 164 (N.D. Cal. 1962) aff'd

[27]As we noted above, the court in *North Atlantic* held that if creditors of the charterer who had attached the subfreights on claims unrelated to the voyage had succeeded in receiving actual payment of their claims from the attached funds "plainly the shipowner's lien would have been lost." If this be the result on the involuntary satisfaction of an attachment, the same result must follow *a fortiori* on the satisfaction and payment of a voluntary assignment such as was accomplished in the case at bar.

sub nom, San Rafael, Etc. v. American Smelting Etc., Co., 327 F. 2d 581 (9th Cir. 1964), cited by libelant, is distinguishable in that the monies involved, which were unequivocally subfreights, had not been paid by the third party shipper to the charterer or its successor, but rather had been interpleaded and deposited in court. Furthermore, the citation of the case even for the proposition that an owner's lien prevails over an executory assignment cannot be sustained since the court there found that there had been inadequate proof of the validity of the alleged assignment and made its decision upon that ground and not upon any legal issue of priorities.[28]

American Smelting actually supports the Bank's position herein in one important aspect. The case involved conflicting claims to unpaid subfreights earned by a voyage of the S. S. Ocean Alice and the unpaid portion of subfreights owed from three prior voyages of the Ocean Alice and two other ships. Ninety-five percent of the subfreights from these prior voyages had been previously *paid* to the charterer's assignee through its bank. No issue or contention was made that the ship-

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[28]In the opinion of the District Judge cited at 208 F. Supp. 164 at 169 (1962), it is said: "While it is well established that freights of a voyage may either be sold outright by assignment or assigned as security for a loan, [the alleged assignee] has failed in its burden to show a valid assignment has been made of the freights of the second voyage of the Ocean Alice." The most the *American Smelting* and other decisions relied on by libelant could be cited for is the proposition that a shipowner's lien has priority over an *executory* assignment of subfreight if the lien is asserted before payment of the subfreights by the party liable therefor. This point, even if conceded, does not help libelant here since we are not dealing with an executory assignment, but rather with subfreights which were prepaid before assertion of the shipowner's lien.

owners had any lien upon the subfreights previously paid (as distinguished from the unpaid portion of the subfreights which were in issue) and the possession of the paid subfreights was not disturbed. Therefore the court as well as the parties implicitly drew a distinction between unpaid and paid subfreights and in the latter case indicated that there was no shipowner's lien thereon. Applying the result reached in *American Smelting* case to the matter at bar it is apparent that libelant's lien under any circumstances could only be as to any unpaid freights owed by the consignees or shippers. Any lien upon the freights which have been paid, was discharged upon payment.

Luckenbach Overseas Corp. v. Subfreights of S.S. Audrey J. Luckenbach, 232 F. Supp. 572 (S.D. N.Y. 1963), another case cited below by libelant, is equally non-supportive of the judgment in the case at bar, and in fact supports the contentions of respondent. In *Luckenbach* the libel was against freight monies which were still in the hands of the shipper and which were admittedly due (i.e., unpaid subfreights) and was a contest between a vessel owner and a stevedore. The court held that the stevedore, by reason of a "prohibition of lien clause" in the charter party, could assert no lien on the vessel or its subfreights and the stevedore's executory, unperformed assignment of subfreights was to freights which were unpaid and therefore still subject to the owner's lien. The case, then, is dissimilar to the present proceeding which involves alleged subfreights which have been entirely paid and therefore no longer subject to any lien in favor of the shipowner. This distinction (i.e., the loss of the shipowner's lien upon payment of the subfreights) which

is the major issue in the case at bar, was noted by the court in *Luckenbach* on rehearing and stated as follows:

> "The subfreights had not been paid by Barr [the third party shipper] and these proceedings were commenced by the owner to execute its lien.
>
> *"Of course, had Barr paid the charterer, the situation as to Barr would be different. But there has been no payment."* (232 F. Supp. at 577 (emphasis ours)

Thus the court noted the very point respondent asserts here: that regardless of the relative priorty of the shipowner's lien before the subfreights are paid, if they are paid before the lien is asserted, the shipowner's lien falls and is no longer applicable to the paid subfreights.

The case of *Schirmer Stev. Co. Ltd. v. Seaboard Stev. Corp.,* 306 F. 2d 188 (9th Cir. 1962) relied upon by libelant and which also involved unpaid subfreights, is similarly distinguishable. That case involved substantially the same parties as *American Smelting* and once again the court held that the purported assignment was inoperative since the vessel was withdrawn by the owners before the freights covered by the assignment were earned. Therefore, *Schirmer,* like *American Smelting,* was not decided upon the issue of priorities, but rather upon the factual finding that the assignment was ineffective. The court in *Schirmer* expressly declined to pass on what the relative priorities would have been had the executory assignment been valid. (See discussion 306 F. 2d at 191-192).

There is a further aspect of *Schirmer* which is worthy of note. That case also involved the rights of certain attaching stevedores *vis a vis* the shipowner;

these stevedores attached the subfreights on independent claims not related to the voyage in question. Therefore their attachments stood in the same position as the claim of a general creditor of the charterer. The attaching stevedores contended that their attachments had priority over the shipowner's lien. That contention, if sustained, would clearly support the proposition that the shipowner's lien cannot be traced to funds paid to the charterer or its successor in interest. The court in *Schirmer* rejected the stevedores' contention but, significantly, not for the reason that the shipowner's lien was superior, but rather because the attachments were levied prior to the time that the subfreights became payable. Thus the court indicated that had the attachments been validly perfected such attachments would have had priority over the shipowner's lien. The case therefore is entirely consistent with the determination that any shipowner's lien is discharged if the subfreights are paid the charterer (or voluntarily or involuntarily assigned to a creditor of the charterer) prior to the time the shipowner's lien is asserted by appropriate process. [*In re North Atlantic & Gulf Steamship Co., supra.*]

Where a shipowner asserts a lien on unpaid subfreight, the subsequent payment of the third party shipper to a person other than the owner is at the shipper's own risk and does not discharge his liability for the subfreight. Thus, the assertion of the lien is akin to a garnishment. But even such assertion of the lien would not confer the right upon the shipowner to "trace" the lien to the monies paid by the shipper to any other person, and there is no known authority so holding. Therefore, if libelant herein were correct

that its lien was not discharged by prepayment of the alleged subfreight by the consignees, while the consignees might remain liable it would not necessarily follow that the lien could be "traced" and respondent Bank held liable. In other words, the burden is upon libelant to show as a matter of law, not only that it has a lien, but also that it can assert that lien against respondent as distinguished from Kenray or the consignees. There is no authority sustaining such burden. The assertion of libelant that it has a shipowner's lien on subfreights merely begs the issues here. Those issues are (1) has the lien been discharged by the payment of the subfreights and (2) if the lien exists, can it be traced and applied to funds held by third persons. Both issues must be answered adversely to libelant.

In summary, libelant has cited no authority, and we have found none, which supports the judgment below that the shipowner's lien on subfreights exists after the subfreights are paid to the charterer or a third person. What authority does exist is directly contrary to the judgment here and no maritime lien can be sustained upon the funds under attachment. In *Galban Lobo Trading Company S/A v. Diponegaro,* 103 F. Supp. 452 (S.D.N.Y. 1951), where the court in an analogous case refused to extend to a cargo owner a lien on freights which it had prepaid, the court made a statement which is indeed apropos of the claim made by libelant in the case at bar:

> "The law of the sea has passed that period when even the most ingenious and resourceful of proctors might father new rights; it has long left behind the time for the development or belated recognition of maritime liens heretofore unknown and unsuspected." (103 F.Supp. at 453).

III.

The District Court Was Without Jurisdiction to Determine Purely Equitable Claims. In Any Event There Is No Substantive Basis for Its Conclusion That the Bank Was a Constructive Trustee.

Anticipating that its position could not be sustained upon a maritime basis, Compania at pre-trial interjected a claim that it had an equitable lien upon the funds received by the Bank, and that the Bank was a constructive trustee for the benefit of Compania. Objections to the consideration of that non-maritime claim were made by the Bank at pre-trial and trial.[29] The District Judge, however, concluded that he had jurisdiction to consider the claim,[30] and that the Bank received the proceeds of the letters of credit and the Purdy subfreights "as a constructive trustee for the benefit of libelant to the extent that libelant's charter-hire was unpaid,"[31] and that it would be "inequitable" if the Bank could avoid payment to libelant. We respectfully submit that such conclusions are erroneous as a matter of law.

A. The District Court Sitting in Admiralty Had No Jurisdiction to Consider an Independent Equitable Claim.

It is settled that where underlying maritime jurisdiction exists, an admiralty court has jurisdiction to hear and determine equitable matters which are *incidental* to the maritime claim. [*Swift & Co. Packers v. Compania Colombiana Del Caribe S.A.*, 339 U.S. 684, 70

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[29] [R. 181; Rep. Tr. 36-37].

[30] [R. 198-200 (Opinion pp. 7-8); R. 226 (Conclusion 3)].

[31] [R. 226-227 (Conclusions 8, 8A, 8B)].

S. Ct. 861, 94 L. Ed. 1206 (1950)].[32] It is equally settled, however, that the admiralty court, even after acquiring jurisdiction, may not enforce independent equitable claims. Thus in *Swift,* it was said:

> "Unquestionably a court of admiralty will not enforce an independent equitable claim merely because it pertains to maritime property." (339 U.S. at 690).

The difference, for jurisdictional purposes, between an incidental claim and one seeking independent relief was considered by this court in detail in *Putnam v. Lower,* 236 F. 2d 561, 568 (9th Cir. 1956). In so doing, this court recognized that certain types of claims, including that of constructive trust asserted here, are unequivocally independent and not in admiralty jurisdiction. This court said:

> "While admiralty courts are flexible in operation and are often said to act as courts of equity, it does not necessarily follow that they possess jurisdiction concurrent with that of equity, but rather that having once secured jurisdiction as an admiralty court, they may proceed in the trial of the cause on equitable principles. Thus, admiralty 'cannot entertain a bill or libel for specific performance, or to correct a mistake, * * * *or declare or enforce a trust or an equitable title* * * * or exercise jurisdiction in matters of accounts merely * * *'. Nor does admiralty have jursdiction extending to actions seeking affirmative relief from fraud, or seeking to set aside or reform contracts, merely because there is a maritime flavor to the transaction." (empahsis ours.)

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[32]In *Swift,* the Supreme Court held that a court of admiralty could consider, for purposes of attachment, a claimed fraudulent transfer of a vessel.

While this court in *Putnam* adhered to the "incidental equities" rule, it is clear from the decision that certain types of claims, including claims to impose a constructive trust, are by their very nature considered independent and outside the scope of admiralty jurisdiction. This case falls within that class; Compania's constructive trust theory was clearly not an incident to its alleged maritime lien, but is rather a separate and alternative claim.[33] *Putnam,* moreover, establishes that where (as here) the equitable matter is asserted affirmatively rather than defensively, less latitude should be allowed in accepting jurisdiction.

Claims which are independently equitable in nature, even though flavored with maritime facts, have consistently been held to be outside the jurisdiction of the Admiralty Court. An apposite case demonstrating that there was no jurisdiction to consider Compania's claim of constructive trust, even though joined with a claim of maritime lien, is *Port Welcome Cruises, Inc. v. S.S. Bay Belle,* 215 F. Supp. 72, 84-85 (D.C. Md. 1963); aff'd. *sub. nom. Humble Oil & Refining Co. v. S.S. Bay Belle,* 324 F. 2d 954 (4th Cir. 1963). In *Port Welcome* the court was called upon to determine the validity and relative priorities of certain ships' preferred mortgages and other maritime liens upon vessels, where the holder of the mortgages also held additional security interests in non-maritime property; the court initially held that the ships' preferred mortgages were valid and had statutory priority. The junior maritime lienors then asserted that since the senior mortgagees

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[33]It cannot be questioned that an action to establish a constructive trust lies exclusively in the field of equity [See *Black v. Boyd,* 248 F. 2d 156, 162 (6th Cir. 1957).]

held other non-maritime security, a constructive trust should be impressed on that security so that there could be a marshalling of assets. The court refused to impose such a trust as being outside its admiralty jurisdiction, and after reviewing *Swift* and other authorities said:

> "[B]ut this extension of the doctrine that courts of admiralty may apply equitable principles has been extended only to matters which are subsidiary but a necessary adjunct to full maritime relief . . .
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> "In the cases at bar, the lienor's contention would require the Court, not only to apply equitable principles but to apply those principles to non-maritime property, here, Riverview Beach Park. It would require the Court to impose a constructive trust on this piece of realty and, of course, administer such a trust. No cases have been cited, nor has any been found, where a trust has been imposed on non-maritime property by an admiralty court, except in perhaps a limitation of liability proceeding. (authority) It is concluded that this Court does not have such jurisdiction." (215 F. Supp. at 85)

See also:

The Eclipse, 135 U.S. 599, 608, 10 S. Ct. 873, 34 L. Ed. 269 (1890) [Holding that admiralty court had no jurisdiction to determine claims of equitable title to a vessel.]

F. D. Marchessini & Co. v. Pacific Marine Corp. 227 F. Supp. 17, 20 (S.D. N.Y. 1964) [Holding that action for accounting of funds under ship agency agreement not within in-

cidental admiralty jurisdiction even though respondent was to collect freights and receipts from operation of ships.]

Economu v. Bates, 222 F. Supp. 988, 991-92 (S.D. N.Y. 1963). [Action alleging agreement to become co-owner of vessel and to share freight monies from operation held not to be within admiralty jurisdiction.]

The District Court here, in assuming jurisdiction over a specific equitable claim, went far beyond the incidental relief concept. This is demonstrated by the complete absence of any cited case in which a constructive trust was found or declared by an admiralty court upon non-maritime property such as the funds received by the Bank. If the holding of the District Court is sustained, admiralty jurisdiction over equitable claims could always be obtained by the expediency of joining a maritime lien claim, no matter how groundless. Certainly, such a boot-strapping of jurisdiction was not contemplated by *Swift* and is inconsistent with the history of the admiralty. In summary, then, we believe that the District Court erroneously concluded that it had jurisdiction to pass upon Compania's equitable claims.

B. There Is No Substantive Basis for the Imposition of a Constructive Trust and the Findings of the District Court Do Not Support Its Conclusion.

Assuming, *arguendo*, that jurisdiction is sustained, the judgment of the District Court must nevertheless be reversed in that the findings of the District Court do not support its conclusion that a constructive trust should be imposed and none of the elements of a constructive trust are present.

It is hornbook law that a constructive trust may be imposed only where one acquires property to which he is not entitled by reason of fraud, accident, mistake undue influence or the violation of an express trust or confidential relationship.

California Civil Code, §2224;

4 Witkin, *Summary of Calif. Law,* pp. 2970-2972;

Bogart, *Trusts and Trustees* (2nd Ed.) §471-475;

Scott on Trusts (3rd Ed.) Vol. V. §462.2;

Restatement, *Restitution,* 160 and comments;

89 C.J.S. *Trusts,* §139, pp. 1015-1024.

An extraordinary degree of proof is required to establish a constructive trust and the evidence must be clear and convincing so as to leave no reasonable doubt as to the existence of the trust.

E.g.

Fowler v. Security-First Nat. Bank, 146 Cal. App. 2d 37, 43 (1956). ["Not only are the appellants here under the ordinary burden of persuasion in a civil case, but since they are seeking to impose a constructive trust . . . they must establish the oral agreement by *full, clear and convincing evidence* . . ."] (emphasis by court.)

Jacoby v. Shell Oil Co., 196 F. 2d 855, 858 (7th Cir. 1952). ["Proof to establish a constructive trust must be clearly convincing and so strong and unequivocal as to lead to but one conclusion. If the evidence is doubtful or capable of reasonable explanation upon a theory other

than the existence of a trust, it is not sufficient to support a decree declaring and enforcing the trust."]

89 C.J.S. *Trusts,* §158 and cases collected;

Bogert, *op. cit.,* §472.

In the case at bar there are no findings of fact or convincing evidence which justify the impression of a trust.

First, there is no finding of any fraud, actual or constructive, on the part of the Bank, and there is no evidence of any such fraud. The Bank had no contact with Compania and made no representations to it. Insofar as the Bank's dealings with Kenray are concerned, there is no finding or evidence that the Bank represented that it would pay the charter-hire; on the contrary, the findings are clear that the Bank *declined* to obligate itself by the issuance of a letter of credit and that the only statement ever made by a Bank representative was that *Kenray* would have to pay the charter hire. [Stat. of Case, 1., 4. *supra*]

Second, there was no unjust enrichment to the Bank. Kenray was indebted to it for substantially more than was received from the Scaraven cargo and the Bank has suffered a loss of more than $200,000.00, even if successful here. The antecedent indebtedness of Kenray was valid and *bona fide* consideration for the Bank's receipt of payment.

California Civil Code, §3106.[34]

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[34]Section 3106, in effect at the time of the Scaraven's sailing, has been superseded by the California Commercial Code. Section 3106 provided in part "an antecedent or pre-existing debt constitutes value". Commercial Code, Section 1201 defines value as including total or partial satisfaction of a pre-existing claim. To

Smitton v. McCullough, 182 Cal. 530, 538 (1920) ["The rule that a transfer as security for a pre-existing debt is a transfer for value not only as between the parties but as to third persons as well is too well settled in this state to be questioned."]

We are not here concerned with voidable preference in the bankruptcy sense, but rather an alleged trust. As such, there clearly was value given to Kenray and there can be no claims that the Bank was unjustly enriched. Furthermore, even if there were such claims, maritime liens cannot be conferred upon a theory of unjust enrichment.

The Eurana, 1 F. 2d 684, 686 (3rd Cir. 1924) [Court stating: "A maritime lien . . . is *stricti juris* . . . Martime Liens, therefore, cannot be conferred on the theory of unjust enrichment or subrogation."]

The Aljohn, 7 F. Supp. 788, 790 (E.D. N.Y. 1934) ["A maritime lien, being secret and unrecorded, is *stricti juris,* and cannot be conferred on the theory of unjust enrichment or subrogation, and the right of such lien cannot be extended by judicial constructive analogy or reference."]

Third, there is no finding and no evidence of any confidential relationship or of any express trust. The Bank and Compania were both simply creditors of Kenray seeking to enforce their respective rights. We know of no case where the receipt of payment or the

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the same effect are Commercial Code §§ 3303, 3408. The Bank also gave new, as well as antecedent, consideration by advancing additional loans to fill out the Searaven cargo.

exercise of rights by one creditor was deemed to create a constructive trust in favor of another.

It is true, of course, that the Bank was protective of its creditor's position in obtaining the payment of the letters of credit. But, the fact that the Bank exercised an appropriate creditor's remedy and was more careful in protecting its rights does not confer any rights in Compania. "The law helps the vigilant, before those who sleep on their rights". [Calif. Civil Code §3527].[35]

Fourth, an analogous case demonstrating that no constructive trust may be imposed upon one creditor in favor of another creditor is *Zirker v. Baber,* 161 Cal. App. 2d 355 (1958). In *Zirker* it was held that the plaintiffs, who had loaned money to Baber, the proceeds of which were paid by Baber to a third person in satisfaction of a contractual obligation, could not recover from that third person upon a theory of trust or quasi-contract even though there may have been a failure of consideration in the transaction between Baber and the third person. The denial of recovery was upon the grounds that the relationship between plaintiffs and Baber was simply a loan and the extension of credit to Baber for his own purposes, that the third person was not a party to that transaction, that there was no privity between plaintiff and the third person, and that no trust relationship existed between the plaintiff and

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[35]Compania had innumerable ways to protect itself. i.e. Insisting on Kenray's prepayment of charter hire or the delivery by Kenray of satisfactory guarantees of payment; exercising a possessory lien on cargo; refusing to surrender the bills of lading until payment of charter hire was made; requiring that the letter of credit drafts be drawn in its favor; notifying the consignees of its claim for charter-hire before payment was made; or subsequently seeking relief under the Bankruptcy Act by attempting to set aside the payment to the Bank as a voidable preference. — It did none of these or any other acts to protect its position.

the third person. Similarly, in the case at bar, Compania extended credit to Kenray (by not requiring prepayment of the charter hire) and the Bank was concededly not a party to such credit transaction and had no privity or relationship to Compania. There is therefore no basis for any recovery by Compania from the Bank.

Another case demonstrating that a creditor-debtor relationship is insufficient to give rise to a constructive trust is *Woodruff v. Coleman*, 98 A. 2d 22 (D.C. 1953) in which it was held that a physician whose bill for services was unpaid could not impose a constructive trust upon the proceeds of a personal injury settlement received by his patient even though his bill was used in negotiating the settlement. The rational of *Woodruff* was that the physician had no direct right to obtain payment from the tortfeasor which paid the settlement and as a result the patient did not receive any money belonging to the physician.

The mere non-payment of debt is not a circumstance which creates a constructive trust [*McKey v. Paradise*, 299 U. S. 119, 122-123; 81 L. Ed. 75; 57 S. Ct. 124 (1936).[36] Similarly, the mere hope or expectation of a creditor that he will receive payment out of a particular fund will not create a trust. [1 Bogart, *Trust and Trustees* (2nd Ed.) §19, p. 129]. Therefore, the fact that Kenray may have been indebted to Compania

[36]In *McKey*, an employer made payroll deductions which it was required to pay to an employee's welfare association. It failed to make the payments and went into bankruptcy. The welfare association claimed preferential status upon a theory of constructive trust. The claim was not allowed and the court, while exercising sympathy for the employees, noted that the association (as Compania) was simply a creditor and that the "mere failure to pay a debt does not belong in that [constructive trust] category".

and Compania expected that it would be paid from the proceeds of the letters of credit, cannot justify the imposition of a constructive trust upon either the Bank or Kenray. Compania's sole remedy therefore is an action at law against Kenray.

Fifth, there was no evidence of any undue influence or mistake and no finding to that effect. The drafts against the foreign letters of credit were knowingly and intentionally drawn in favor of the Bank. No agreement was made by the Bank to apply the proceeds to the benefit of Compania and none may be judicially created. The Bank did not occupy a fiduciary relationship to Compania, with which it had no contact, and certainly did not do so to Kenray; nor did Kenray occupy a fiduciary position towards Compania. No confidential or fiduciary relationship exists between a creditor and a debtor or between parties who are merely under contractual obligations to each other. [*Waverly Productions, Inc. v. RKO General, Inc.,* 217 Cal. App. 2d 721, 732 (1963).[37]

The findings made by the trial court are devoid of any basis for the imposition of a constructive trust. Rather, it is clear that the basis of the court's decision is that it would be "inequitable" if the Bank could avoid payment of charter hire. That conclusion, however, adds nothing to the necessary legal analysis. There is no more inequity here than is present wherever one creditor is paid and another is not—wherever one creditor is preferred he receives the benefit of credit extended by others and there is nothing *per se* illegal or

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[37]No one would seriously argue that an attachment by a creditor, thereby preferring himself over another, is the basis for a constructive trust. *A fortiori* a voluntary payment or assignment by a debtor to that creditor cannot sustain a trust.

wrong with a preference. We are not concerned here with an apportionment of assets or the avoidance of a preference such as would exist in a bankruptcy proceeding; rather we are concerned with the assertion of an *equity* claim and the fact that something would be fair or equitable does not mean that a cause of action exists. There must be an underlying cause of action and without such there can be no recovery regardless of the relative fairness of any result. Equity does not mean that the court, in a non-bankruptcy context, can redistribute money out of a sense of fairness without regard to the propriety of claims. As is said in 30 C.J.S. *Equity,* § 1, pp. 779-781:

> "While a court of equity is a forum for the administration of justice, 'equity' is not synonymous in meaning with 'justice' or 'natural justice' administrated without fixed rules, although the terms have sometimes been so used. On the contrary, equity is a separate but incomplete system of jurisprudence, administered side by side with the common law, having its own *fixed precedents and principles* now scarcely more elastic than those of the law . . . It is not [a court of equity's] function to assist in creating causes of action . . . *Equity may not and does not under the guise of doing equity create new substantive rights.* . . ."

Regardless of any sense of fairness, the court may not create a new right under the guise of being "equitable". The authorities, discussed above, are contrary to the decision here and the judgment may not be sustained.

IV.

Compania Waived Any Lien Claim It May Have Had and Is Estopped to Assert the Same.

We believe that we have conclusively demonstrated in the foregoing portions of this brief that Compania does not have any valid lien claim against the attached funds or respondent Bank. We further believe that even if a lien ever existed (which it did not) it was waived by the conduct of Compania which was incompatible with the assertion of any lien.

It is established that a maritime lien may be deemed waived by any conduct which is inconsistent with the assertion of a lien. [See *W. A. Marshall & Co. v. The President Arthur,* 279 U.S. 564, 568, 49 S. Ct. 420, 73 L. Ed. 846 (1929); 46 U.S.C.A .§974; 1 *Benedict* on Admiralty (6th Ed.), §89, p. 274.] We believe that the conduct of libelant here is to be deemed a waiver.

First, the Searaven bills of lading issued on behalf of Compania (by the ship's master who was Compania's agent) showed all freight to have been *prepaid.* Where bills of lading are marked "freight prepaid", the shipowner is precluded and estopped from asserting his lien for the unpaid freight owed. [See: The *Robin Gray,* 65 F. 2d 376 (2nd Cir. 1933) cert. den. 290 U.S. 653.] The *Robin Gray* case is significant since there it was held (65 F. 2d at 378) that the shipowner, by reason of the issuance of the prepaid bills of lading, was estopped to assert its lien not only as against the consignees, but also as against factors of the seller who had extended credit to the seller. Thus, the estoppel principle, which comes into play where prepaid bills of lading are issued, is equally applicable to an institution (such as respondent herein) which had extended credit

to the seller-charterer of the goods. The *Robin Gray* case precludes, upon principles of estoppel, the assertion by libelant of any lien herein. The *Robin Gray* decision also indicates that a reference to a charter party in a bill of lading is ineffective to preserve the shipowner's lien if the reference is inconsistent with the specific provision in the bill of lading indicating the freight to have been prepaid. [See also *Gilmore & Black, op. cit.* pp. 192-194.] Compania having issued the "freight prepaid" bills of lading, cannot now rely upon an attempted incorporation of the charter party into the bills of lading so as to preserve its alleged lien for unpaid charter hire.

Second, assuming as Compania argues that it did have a lien and is not estopped to assert it, Compania, both prior and subsequent to the filing of this action, *had actual possession of the cargo, which it voluntarily chose to relinquish.* In fact, some of the cargo was actually removed from the vessel and then reloaded by Compania after the default in payment by Kenray. [R. 221-222 (Find. 11); Rep. Tr. 132]. Had the cargo not been so released, Compania could have rendered this entire litigation moot by satisfying its claim from the cargo; or, at least, making a conditional delivery of the cargo, as was done in the *Jackie Hause,* [181 F. Supp. 165] a case now relied on by Compania. The inescapable fact is that Compania had ample opportunity to hold the cargo to satisfy its claim and chose not to do so. Having made that decision, Compania should not now be permitted to hold the Bank liable. Respondent Bank was not a party to the charter nor to the voyage of the Searaven—Compania was both. If Compania suffered a loss, it was due to its volitional release of

the cargo and not because of any act or breach on the part of respondent. The choice and decision to release the cargo was Compania's and respondent should not be penalized for that determination, however much Compania may now regret it.

Third, it is also significant that Compania did assert a lien against cargo for general average (but not for charter-hire) when the Searaven reached Taiwan, and that such lien was bonded against by the consignees [R. 221-222 (Find. 11); Rep. Tr. 134-135]. The fact that a lien was asserted only for general average demonstrates: (1) That Compania was aware of the waiver of any lien for unpaid charter hire by reason of its issuance of "freight prepaid" bills of lading; and (2) that the argument made below by Compania that the filing of this action was the equivalent of the assertion of a possessory lien is without merit, since the argument is inconsistent with the acknowledgment by Compania of the necessity for the assertion of a possessory lien against cargo for general average.[38]

In concluding that there had been no waiver, the District Judge relied upon the case of *Toro Shipping Corp. v. Bacon-McMillan Etc. Co.,* 364 F. 2d 928 (5th

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[38]The ship's log disclosed that the captain desired to assert a lien for the unpaid freight as well as the general average for repairs made in Honolulu, but was instructed by Compania's agent to release the cargo upon delivery of the general average bond only. [Rep. Tr. 134-135, 125]. That instruction demonstrates that Compania was aware of its waiver of any possessory lien for unpaid charter hire by the issuance of the freight prepaid bills of lading. The lien for general average is co-extensive with that for charter hire, that is, a *possessory* lien upon cargo. [See: *Cutler v. Rae,* 48 U.S., 374, 376; 7 How. 729 (1848) quoted above in Part I of this brief.]

Cir. 1966). We submit that such reliance was misplaced. In *Toro* the court held that a shipowner had no lien on cargo where the consignee had prepaid the cost of the cargo to the charterer. The case therefore not only fails to support Compania, but on the contrary, is entirely consistent with the absence of any lien here. Compania argued below that since *Toro* held the shipowner's lien not to be operative as against a consignee who paid value, it must *per se* be operative against other persons. We submit that this is a most strained and unusual legal analysis and is unsupported by any authority. *Toro* dealt with a controversy between a shipowner and a consignee and the consignee prevailed. It does not follow from that holding that the shipowner should prevail here. The Bank also gave value. [See authorities Footnote 34, *supra.*] Furthermore, it is to be noted that *Toro* dealt only with the circumstances under which a shipowner could assert a valid lien against *cargo.* The statement in the decision that a lien on cargo may be reserved by appropriate bills of lading, except as against a good faith purchaser is therefore not relevant here since this case does not involve a lien asserted against cargo; in fact, Compania expressly declined to assert such a cargo lien; rather than an asserted lien on cargo, we are here dealing with claimed inchoate liens against intangibles; the fact that a lien may be reserved against cargo by so stating in the bills of lading, cannot be equated with a lien against subfreights, which lien fails upon payment thereof prior to the assertion of the lien.

V.

The Award of Interest Was Improper.

As we have demonstrated, there was no basis for the judgment of the District Court. The error below was further compounded by the award of interest to Compania. By arguing the propriety of the allowance of interest we do not concede the merits of any of Compania's claims. We do suggest, however, that the award of interest by the judgment below was improper even upon Compania's theory of the case.

Where an admiralty claim is in contract, an award of interest before judgment is proper. [3 *Benedict on Admiralty* (6th Ed.) §419]. In damage cases it is discretionary [id]. However, the claim here is neither in contract or for damages. The claim against the respondents other than Kenray is an *in rem* claim; therefore regardless of the amount of Kenray's *in personam* debt to Compania, the maximum recovery on the *in rem* claim can be only the amount of the *res*. That principle is no different than the principle applicable to the foreclosure of any common law or admiralty lien.

Under Compania's (and the District Court's) theory of the case the *res* here is the alleged subfreights of $96,750.00 which were "carved out" of the letter of credit and Purdy proceeds. Therefore, even if Compania were correct that such subfreights could be judicially created and that it has a viable lien thereon (i.e. that the lien was not discharged by payment of the subfreights before the lien was asserted or otherwise discharged), its maximum recovery from the attached funds or from any respondent (other than Kenray) is the amount of the *res*, $96,750.00, just as a mortgagee can recover from the mortgaged property no more than

its value, regardless of his total claim against the mortgagor.

This point can be further demonstrated by analogizing this case to an admiralty proceeding against a third party garnishee. In such a garnishee proceeding, the court determines the amount of the indebtedness (i.e. the *res*) owed by the garnishee to the defendant. The plaintiff is then entitled to recover from the garnishee no more than the amount of such indebtedness regardless of the amount owed by the defendant to the plaintiff and regardless of the amount actually placed under attachment.

The judgment here, under any theory, must limit the interest claim to the personal judgment against Kenray, and any recovery from the attached funds or respondent Bank can in no event exceed $96,750.00. We do not concede the propriety of any of Compania's claims. We submit, however, that even upon the basis of those claims there cannot be an award of interest.

Conclusion.

The judgment appealed from should be reversed with directions to the District Court to enter judgment in favor of respondent Bank and to order the release to respondent of the funds deposited in court pursuant to Admiralty Rule 37.

Respectfully submitted,

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Certificate.

I certify that, in connection with the preparation of this brief, I have examined Rules 18, 19 and 39 of the United States Court of Appeals for the Ninth Circuit and that, in my opinion, the foregoing brief is in full compliance with those rules.

JEROME L. GOLDBERG